



# Mitigating the Social Costs of the Asian Crisis

A preliminary analysis of the impact of the Asian crisis shows that poverty could increase significantly in Indonesia, Korea, and Thailand. These countries' IMF-supported programs incorporate many measures to mitigate the effects of the crisis. But if the crisis deepens, additional policy options will need to be considered.

**T**HE SIMILARITIES in the economic problems currently besetting Indonesia, Korea, and Thailand conceal significant differences in social conditions in the three countries. Before the onset of the Asian crisis a little over a year ago, Indonesia had a larger number of poor people (22 million, compared with 7 million in Korea and 8 million in Thailand) in absolute terms, but the percentage of the total population living below the poverty line was smaller in Indonesia than in the other two countries. This is partly because Indonesia's poverty line is set lower—it is about 5 percent of Korea's poverty line and less than 40 percent of Thailand's, in U.S. dollar terms—which reflects differences in the cost of living and social norms. Social indicators show that, before the crisis, Korea and Thailand had made more progress in such areas as health and education than Indonesia, which has the lowest life expectancy of the three (Korea has the highest) and the highest infant mortality and adult illiteracy rates (Korea's are the lowest).

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## The crisis and the poor

The Asian crisis will affect households through a variety of channels—sharp exchange rate depreciation, financial sector collapse, corporate bankruptcy, changes in rates of return on assets, and monetary tightening. Although most households will be hurt, those working in the export and agricultural sectors may benefit from higher prices for their products.

The economic crisis and the adjustment programs now being implemented in Indonesia, Korea, and Thailand are likely to hurt low-income households primarily through price increases and the loss of jobs. Prices are rising in all three countries as a result of large exchange rate depreciations and increases in public tariffs and indirect taxes. Consumer price inflation in Korea has been relatively subdued, despite the steep drop in the won's value, reflecting falling domestic demand and the absence of wage pressures.

In Indonesia, however, consumer price inflation was 46.5 percent in the first six months of 1998, and food prices jumped 35 percent in the first quarter of 1998. In Thailand, food prices have gone up 7 percent since the crisis began. Layoffs are further reducing the real incomes of households. As the number of corporate bankruptcies climbed in Korea, the unemployment rate reached 7.0 percent, on a seasonally adjusted basis, in May 1998, compared with 5.9 percent in February 1998 and 3.4 percent in March 1997.

The short-term, first-round effect of the economic crisis on the poor and vulnerable can be estimated by using data on expenditures of households, broken down by income group, and on increases in prices and unemployment for 1998. The analysis is tentative, however, because it is unclear to what extent the amount of purchasing power lost as a result of inflation will be offset by nominal wage increases or reinforced by nominal wage cuts. It is also difficult to speculate on the extent to which income losses will be mitigated by dissaving, informal safety nets (particularly in Indonesia and Thailand), and corporate safety nets (in Korea). In previous economic downturns in Korea (1980), Indonesia (1983), and Thailand (1984), these instruments played a role in cushioning the impact of declining income on household consumption.

## Price effects

The impact of price increases on poverty will be greatest if mean real consumption of households declines by the average annual price increases projected for 1998 (Table 1). However, households that work in the agricultural sector and produce more than they consume are affected differently by price increases; their net earnings would increase, although higher input costs would, to some extent, offset these gains. Agricultural households probably account for more than 25 percent of the Thai population and tend to be concentrated at the lower end of the income distribution; the likely increase in their earnings will therefore cushion the impact of price increases on poverty.

The impact on households of price increases for specific commodities will depend on the share of these items in the

Table 1  
**Price increases in 1998**  
(percent)

	Indonesia	Korea	Thailand
General price increases <sup>1</sup>	60.0	8.0	9.7
Specific price increases <sup>2</sup>			
Food	35.0	...	7.0
Energy and transportation	...	15.6	11.0

Sources: IMF program documents, and national price statistics.

Note: ... indicates data are not available.

<sup>1</sup> General price increases reflect estimated average inflation for 1998 (June 1998 estimate).

<sup>2</sup> Actual price increases since the start of the economic crisis; for Indonesia, the average increase in food prices in the first quarter of 1998 is presented.

consumption basket. In Indonesia and Thailand, food items make up a relatively large share of the poor's consumption basket—71 percent in Indonesia and about 55 percent in Thailand. Thus, the effect of higher food prices on the number of people living below the poverty line would be relatively large in these two countries, particularly in Indonesia, where 30 percent of the population is clustered just above the poverty line. This is borne out by the elasticity of the number of poor people with respect to mean consumption expenditures, which is estimated at -1.9 in Thailand and about -2.7 in Indonesia—that is, the number of poor people is much more sensitive to changes in the average consumption level in Indonesia than it is in Thailand. In addition, since the national poverty line is relatively low in Indonesia, declines in household consumption have a significant impact on the severity of poverty.

### Unemployment effects

At this stage of the crisis, it is still difficult to predict how many, and what types of, jobs will be lost. However, estimates by governments, national research institutes, and the International Labor Organization suggest that the loss of jobs is likely to be large (Table 2).

In Indonesia and Thailand, job losses in the formal sector would force skilled workers to move to the agricultural and informal sectors; in Korea, the working middle class would be hit hardest. This suggests that, in all three countries, households in the upper and bottom income quintiles would not be affected by job losses as much as other income groups. If unemployment projections prove correct, as many as 11.8 percent of all Indonesian households, 8.2 percent of Korean households, and 6.7 percent of Thai households would be affected, if one person per household were to become unemployed. (The average household size in the three countries ranges from 3.7 persons in Korea to 4.5 persons in Indonesia.) If unemployment numbers turn out to be higher than the projections in Table 2, the number of affected households would increase proportionally.

The increase in unemployment will reduce average real household consumption in the three countries, depending on how much household incomes decline. For instance, in Indonesia, average consumption would decrease by about 30 percent in households affected by unemployment if these households were initially clustered in the middle three deciles of the household expenditure distribution and slid one decile after a household member became unemployed. Estimates based on similar assumptions for all three countries show that the increase in the number of poor people in relation to the total population as a result of rising unemployment would be highest in Thailand and lowest in Korea.

### Existing social protection arrangements

In all three countries, the government provides for social benefits, including pensions for old age, disability, and survivors; sickness and maternity benefits; and work injury benefits. However, coverage is limited. In Indonesia, pensions are provided to civil servants and military personnel, but coverage beyond these groups is extremely limited. Indonesia also has various village-based social assistance programs that are targeted to the poor and a variety of disadvantaged groups. In Thailand, a mere 10 percent of the labor force is covered by the pension system. Only Korea has formal unemployment insurance, although coverage is limited to firms with more than 5 workers (before June 1, 1998, the threshold was 10 workers). In addition, Korea has public assistance programs including means-tested subsidies for health care, insurance, and social welfare programs. Moreover, the job-for-life tradition has meant that Korean firms have provided a significant part of the country's social safety nets. However, as pressures to restructure the corporate sector in Korea mount, it is unlikely that enterprises will be in a position to provide the same level of social protection as in the past.

### Social protection in IMF-supported programs

The challenge in the three countries has been to establish cost-effective and fiscally sustainable safety nets that do not create the types of large labor market disincentives (such as overly generous unemployment benefits) seen in some of the countries belonging to the Organization for Economic

Table 2  
**Estimated unemployment**  
(millions of workers)

	Indonesia	Korea	Thailand
1996	4.4	0.4	0.5
1997	...	0.7	1.2
1998	10–15	> 1.5	2.0

Sources: IMF program documents, national employment statistics, and International Labor Organization.

Note: ... indicates data are not available.


Cooperation and Development and that do not discourage job creation in promising sectors. (The service sector, in particular, has great potential for generating new jobs in all three countries.) The Mexican crisis of 1994–95 demonstrated the importance of maintaining labor market flexibility to mitigate the impact of an economic downturn on jobs. It is likely that some of the unemployed in Indonesia and Thailand will be absorbed by the urban informal sector, as happened in Mexico. Furthermore, as employment opportunities dry up in urban areas, workers may migrate to rural areas. These movements of labor would reduce the demand for assistance through formal safety nets.

IMF-supported programs in Indonesia, Korea, and Thailand incorporate a mix of existing and new policy instruments to shelter the poor and vulnerable from the adverse effects of the crisis and economic adjustment:

- In Indonesia, government spending on social safety nets is programmed to amount to 7.5 percent of GDP in fiscal year 1998/99. Across-the-board subsidies on food, fuel, electricity, medicine, and other essential items are estimated to amount to 6 percent of GDP. These subsidies help to contain increases in the cost of living for all households, including

the poor and vulnerable. In addition, the World Bank, the Asian Development Bank, and bilateral donors are supporting the expansion of employment-generating public works programs targeted to poor households. The United Nations World Food Program is establishing food-for-work programs, especially in drought-stricken areas. The Indonesian government plans to increase spending on health care for vulnerable groups, village health centers, and immunization; budget allocations for school lunch programs, scholarships, and block grants to schools are also being increased. In addition, the government is expanding the amount of credit it makes available to people in rural areas and to small and medium-sized enterprises.

- In Korea, unemployment insurance coverage will be extended, in several different stages, to all workers in firms with more than five employees. In addition, the minimum benefit will be raised from 50 percent to 70 percent of the minimum wage; the minimum duration of benefits will be increased from one to two months; and eligibility will be temporarily extended by reducing the minimum period of required contributions from one year to six months. The Korean government will also provide training for 250,000 persons in 1998, while subsidizing



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in-house training by firms. To protect households that are insufficiently covered by unemployment insurance, allocations for social welfare assistance will increase, and the government is providing funds amounting to 0.6 percent of GDP for special loan programs for the unemployed.

- The Thai government, with financial support from the World Bank, has introduced temporary labor-intensive civil works programs in construction and infrastructure rehabilitation. It will pay social security contributions for unemployed workers for at least six months after they are laid off. It will also strengthen social spending, with financial support from the Asian Development Bank: it will expand scholarship and loan programs to minimize student dropouts, protect operational budgets for teacher training and instructional materials, and reallocate resources toward health programs for the poor. Finally, government subsidies for urban bus and rail fares will be maintained to protect urban low-income workers.

These initiatives are likely to help the poor weather the crisis. But it may be necessary to further expand social protection measures if the crisis becomes deeper or more protracted than is currently expected.

### Strengthening social protection

There are several options for strengthening social protection in the three countries.

- In Indonesia, it is essential to target subsidies more effectively to reduce government expenditures while continuing to protect the living standards of the poor. Richer households now consume a significantly greater share of most subsidized products than low-income households. Therefore, the government could consider subsidizing lower-quality commodities predominantly consumed by the poor (for

example, coarser varieties of rice). It is also critical that the government maintain an effective system of food distribution, either on its own or with the assistance of the private sector and nongovernmental organizations. In addition, community-based public works programs could be expanded while the administrative capacity to implement these programs is strengthened. Finally, the government could consider subsidizing public transportation, rather than fuel consumption.

- In Korea, unemployment benefits could be extended to individuals in enterprises with fewer than five workers. More than 5 million workers—about 40 percent of the private sector workforce—are employed in these enterprises and thus remain outside the coverage of the unemployment-benefit scheme. Although eligibility for unemployment benefits has been extended to workers who have contributed for only six months, workers in firms with between 5 and 10 workers—because the threshold was not lowered until June 1, 1998—will receive benefits for only two months if they become unemployed in 1998. This may prove to be insufficient as a safety net. Either eligibility conditions could be further relaxed or budgetary provisions for those seeking social assistance could be increased. The government could also consider public works programs.

- In Thailand, further expansion of public works programs could be the principal vehicle for strengthening social safety nets. **F&D**

*This paper is drawn from Sanjeev Gupta, Calvin McDonald, Christian Schiller, Marinus Verhoeven, Željko Bogetić, and Gerd Schwartz, 1998, "Mitigating the Social Costs of the Economic Crisis and the Reform Programs in Asia," IMF Paper on Policy Analysis and Assessment 98/7 (Washington: International Monetary Fund).*

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